

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the State conform in all material respects to Generally Accepted Accounting Principles (GAAP) as applicable to governments. The Governmental Accounting Standards Board (GASB) is the standard setting body for establishing governmental accounting and financial reporting principles, which are primarily set forth in the GASB's Codification of Governmental Accounting and Financial Reporting Standards (GASB Codification). Following is a summary of the significant policies:

A. Reporting Entity

Michigan was admitted to the Union as the twenty-sixth state in 1837. The State of Michigan is governed under the Constitution of 1963, as amended. The legislative power is vested in a 38-member senate and a 110-member house of representatives; executive power is vested in a governor; and the judicial power is vested exclusively in one court of justice.

For financial reporting purposes, the State of Michigan's reporting entity includes the "primary government" and its "component units." The primary government includes all funds, departments and agencies, bureaus, boards, commissions, and those authorities that are considered an integral part of the primary government. Component units are legally separate governmental organizations for which the State's elected officials are financially accountable. Component units can also be legally separate, tax-exempt entities that raise and hold economic resources for the direct benefit of a governmental unit.

Financial accountability is defined in GASB Statement No. 14, The Financial Reporting Entity. The State is financially accountable for those entities in which the State appoints a voting majority of an organization's governing authority, and either is able to impose its will upon the entity or there exists a financial benefit or burden relationship with the State. For those entities in which the State does not appoint a voting majority of the governing authority, GASB Statement No. 14 requires inclusion in the reporting entity if they are fiscally dependent on the State or if it would be misleading to exclude the authority.

GASB Statement No. 39, Determining Whether Certain Organizations Are Component Units, an amendment of GASB Statement 14, establishes criteria for legally separate, tax-exempt entities that should be reported as component units if all of the criteria are met. Although the State has not identified any organizations that would qualify as direct component units of the State by meeting all of the criteria of GASB Statement No. 39, most of the university component units described later in this note have significant foundations that meet the criteria of GASB Statement No. 39.

Blended Component Units

The State Building Authority and the Michigan Underground Storage Tank Financial Assurance Finance Authority are legally separate organizations that have boards appointed by the primary government and provide services primarily to benefit the State. Therefore, they are reported as though they were part of the primary government, using the blending method.

Discretely Presented Component Units

These types of component units are reported in separate columns or rows in the government-wide statements to emphasize that they are legally separate from the government.

The State is able to impose its will upon these discretely presented component units:

The Land Bank Fast Track Authority receives tax reverted properties, undertakes expedited action to clear their titles, and then ensures the properties' redevelopment.

The Michigan Education Trust offers contracts, which, for actuarially determined amounts, provide plan participants with future tuition at institutions of higher education.

The Michigan State Housing Development Authority finances loans for the construction of single and multi-family housing and home improvement projects.

The Michigan Municipal Bond Authority assists local units by pooling their borrowing activities. This authority is also responsible for assisting local units with their financing of water pollution control projects.

The Mackinac Bridge Authority accounts for the operation of the Mackinac Bridge.

The Michigan Broadband Development Authority is a financing authority that assists in the build-out of broadband infrastructure to accelerate the deployment of high-speed Internet connections Statewide.

The Michigan Exposition and Fairgrounds Authority conducts an annual state fair and other exhibits and events for the purpose of promoting all phases of the economy of this State. The fair, exhibits, and events encourage and demonstrate agricultural, industrial, commercial, educational, entertainment, tourism, technological, cultural, and recreational pursuits.

The Michigan Higher Education Assistance Authority is the State guaranty agency under the Stafford Loan Program, the Supplemental Loans to Students Program, and the Parent Loan for Undergraduate Students Program. This Authority also administers scholarships and grants that are financed with General Fund appropriations.

The Michigan Higher Education Facilities Authority accounts for the administration of no-commitment debt issued for the benefit of private institutions of higher education.

The Michigan Higher Education Student Loan Authority is a financing authority that makes loans to students or their parents.

The Michigan Public Educational Facilities Authority partners with other states to facilitate the acquisition of capital for the construction, rehabilitation, refurbishing, or equipping of qualified public educational facilities.

The Michigan State Hospital Finance Authority accounts for the administration of limited obligation debt issued for the benefit of hospitals.

The Michigan Strategic Fund provides business enterprises with additional sources of financing.

There is a financial burden/benefit relationship between these entities and the State:

The Mackinac Island State Park Commission operates the Mackinac Island and Michilimackinac State Parks.

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Notes to the Financial Statements

The Michigan Economic Development Corporation manages programs to stimulate, coordinate, and advance economic development in the State.

The following entity's relationship with the State would be misleading if it were omitted from the State's reporting entity:

The State Bar of Michigan is a public body corporate whose membership consists of persons licensed to practice law.

Ten of the State's public universities are considered component units because they have boards appointed by the primary government. Their balances and operating results are included with the other discretely presented component units on the government-wide statements. The ten universities included in these statements are: Central Michigan University, Eastern Michigan University, Ferris State University, Grand Valley State University, Lake Superior State University, Michigan Technological University, Northern Michigan University, Oakland University, Saginaw Valley State University, and Western Michigan University. Michigan State University, the University of Michigan, and Wayne State University are not included in the State's reporting entity because they have separately elected governing boards and are legally separate. The State provides significant funding to support these institutions; however, under GASB Statement No. 14 criteria, they are considered fiscally independent, special-purpose governments.

Included in the balances and operating results for most of the university component units is financial activity for fund-raising foundations that contribute to these universities. Although the universities do not control the timing or amount of receipts from their foundations, the majority of resources, or income thereon, that the foundations hold and invest are restricted to the activities of the respective universities by the donors. Because these restricted resources held by the foundations can only be used by, or for the benefit of, the specific universities, the foundations are considered component units of the universities and are included in the universities' financial statements.

Significant Transactions

The State's significant transactions with its major discretely presented component units result primarily from providing appropriations to the public universities, including \$85.0 million to Central Michigan University and \$131.3 million to Western Michigan University.

Availability of Financial Statements

The State's component units issue their own separately issued audited financial statements. These statements may be obtained by directly contacting the various component units. To obtain their phone numbers, you may contact the Office of the State Budget, Office of Financial Management, Financial Reporting Section at (517) 373-3029.

Related Organizations

The State's Insurance Commissioner is responsible for appointing the members of the boards of the Michigan Catastrophic Claims Association and the Michigan Property and Casualty Guaranty Association, but the State's accountability for these organizations does not extend beyond making the appointments.

The State's Governor is responsible for appointing the members of the board of the Venture Michigan Fund, a private non-profit corporation. The State's accountability for this organization does not extend beyond the Governor's appointments. The Michigan Economic Development Corporation, a discretely presented component unit, has loaned \$100,000 to the Venture

Michigan Fund. This loan is to be repaid once the Venture Michigan Fund has raised \$50 million in revenue.

Joint Ventures

As discussed in more detail in Note 7, the State participates in two joint ventures. Their financial activities are not included in the State's fund financial statements, but the State's equity interest is recorded as an asset in the Statement of Net Assets.

Jointly Governed Organizations

The State, the University of Michigan, Michigan State University, and Wayne State University appoint members of the board of the Michigan Public Health Institute (MPHI), a non-profit corporation. MPHI was established to plan, promote, and coordinate health services research with a public university or a consortium of public universities in the State. The State does not appoint a majority of the board, has no rights to the assets, and is not responsible for debts of MPHI. Therefore, the State's accountability for MPHI does not extend beyond making the appointments. During fiscal year 2004-2005, the State awarded contracts totaling \$26.8 million to MPHI.

The City of Detroit, Charter County of Wayne, and the Department of Community Health of the State of Michigan appoint members of the board of the Detroit Wayne County Health Authority (DWCHA), a public agency. DWCHA was established to plan, promote, and coordinate health services for at-risk population in the City of Detroit and Wayne County. The State does not appoint a majority of the board, has no right to the assets, and is not responsible for debts of DWCHA; therefore, the State's accountability for DWCHA does not extend beyond making the appointments. The State did not award contracts to DWCHA during fiscal year 2004-2005.

B. Government-Wide and Fund Financial Statements

Government-Wide Financial Statements

The Statement of Net Assets and Statement of Activities report information on all non-fiduciary activities of the primary government and its component units. Primary government activities are distinguished between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

The **Statement of Net Assets** presents the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets that do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

The **Statement of Activities** demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function, and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are instead reported as general revenue.

Fund Financial Statements

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide statements. Major individual governmental funds and major individual proprietary funds are reported as separate columns in the fund financial statements, with non-major funds being combined into a single column.

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Measurement Focus and Basis of Accounting

The government-wide statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

As allowed by GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting, the State's proprietary funds follow all GASB pronouncements and those Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement. FASB pronouncements issued after November 30, 1989, are not followed in the preparation of the accompanying financial statements.

Governmental fund statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become *susceptible to accrual*; generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the State generally considers tax revenues and court settlements to be available if they are collected within 60 days of the end of the fiscal period. Revenues that the State earns by incurring obligations are recognized in the period when all applicable eligibility requirements have been met and the resources are available.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to debt service, compensated absences, and claims and judgments, are recorded only when payment is due and payable.

Financial Statement Presentation

The State reports the following major governmental funds:

The General Fund is the State's primary operating fund. It accounts for all financial resources except those required to be accounted for in another fund.

The Counter-Cyclical Budget and Economic Stabilization Fund, commonly referred to as the "Rainy Day Fund," was created to assist in stabilizing revenue during periods of economic recession.

The School Aid Fund's purpose is to aid in the support of the public schools and the intermediate school districts.

The State reports the following major enterprise funds:

The State Lottery Fund accounts for the operations of the State's lottery, bingo, and charitable game operations.

The Michigan Unemployment Compensation Funds receive contributions from employers and provide benefits to eligible unemployed workers.

Additionally, the State reports the following fund types:

Governmental Fund Types:

Special Revenue Funds - include operating fund activities financed by specific revenue sources that are legally restricted for specified purposes. Examples include conservation, transportation, regulatory, and other activities.

Debt Service Funds - account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Capital Projects Funds - account for the acquisition or construction of major State capital facilities financed by bond proceeds and commercial paper notes.

Permanent Funds - report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that benefit the government or its citizenry, such as veterans, state park preservation, and others.

Proprietary Fund Types:

Enterprise Funds - report the activities for which fees are charged to external users for goods or services, such as the State's liquor sales. This fund type is also used when the activity is financed with debt that is secured by a pledge of the net revenues from the fees.

Internal Service Funds - provide goods or services primarily to other agencies or funds of the State, rather than to the general public. These goods and services include prisoner-built office furnishings; motor pool services; printing, reproduction and mailing services; information technology; risk management; and health-related fringe benefits. In the government-wide statements, internal service funds are included with governmental activities.

Fiduciary Fund Types:

Pension (and other employee benefit) Trust Funds - report resources that are required to be held in trust for the members and beneficiaries of the State's defined benefit pension plans, defined contribution plans, and other postemployment benefit plans.

Private Purpose Trust Funds - report resources of all other trust arrangements in which principal and income benefit individuals, private organizations, or other governments. Examples include the State's Escheats Fund, gifts to the State, worker disability monies, and others.

Agency Funds - report assets and liabilities for deposits and investments entrusted to the State as an agent for others.

D. Fiscal Year-Ends

All funds and discretely presented component units are reported using fiscal years which end on September 30, except for the Michigan State Housing Development Authority and the ten State universities, which utilize June 30 year-ends.

E. Assets, Liabilities, and Net Assets/Fund Balance

Cash and Cash Equivalents

On the Statement of Cash Flows, the amount reported as "Cash and cash equivalents" is equal to the total of the amounts reported on the Statement of Net Assets as "Cash" and "Equity in Common Cash," less the amount of "Warrants outstanding."

Cash

Cash reported on the Statement of Net Assets and the Balance Sheet consists of petty cash, undeposited receipts, deposits in transit to the Common Cash pool, and cash equivalents such as short-term investments with original maturities of less than three months that are used for cash management, rather than investing activities.

Equity in Common Cash

The State Treasurer maintains centralized management of most State cash resources (not including component units). From the perspective of the various State funds, the pool functions as both a cash management pool and a demand deposit account. The operations and investments of the Common Cash pool are described in Note 5.

Taxes Receivable

Taxes receivable represent amounts due to the State at September 30, which will be collected sometime in the future. In the government-wide financial statements, a corresponding amount is recorded as revenue. In the governmental fund financial statements, the portion considered "available" (i.e., received by the State within approximately 60 days after year-end) is recorded as revenue; the remainder is recorded as deferred revenue. Application of the measurability and availability criteria regarding taxes is described in Note 6.

Amounts Due From Federal Agencies

For most federally funded programs, revenue is accrued in the same period as related obligations are recorded. In certain programs financed entirely by the federal government, expenditures and related revenues are recognized only to the extent of billings received by fiscal year-end. This treatment, which is generally limited to certain programs within the Department of Education, understates both assets and liabilities, and expenditures and revenues; however, there is no impact on net assets or fund balance.

Inventories

Inventories are valued at cost, primarily using the first-in, first-out flow method. Expenditures (governmental funds) and expenses (proprietary funds) are recognized using the consumption method (i.e., when used or sold).

Investments

Generally, investments are reported at fair value, consistent with the provisions of GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools. Short-term, highly liquid debt instruments including commercial paper, banker's acceptances, and U.S. Treasury obligations are reported at amortized cost. Additional disclosures describing investments are provided in Note 8.

Security Lending Collateral

Securities on loan for cash collateral are reported in the Statement of Net Assets. Liabilities resulting from the security lending transactions are also reported. Additional disclosures describing security-lending transactions are provided in Note 8.

Other Assets

Other assets include receivables, amounts held in escrow, and other types of assets not reported on other lines.

Mortgages and Loans Receivable

Mortgages and loans receivable are reported net of unamortized premiums, discounts, deferred loan origination fees, and allowances for possible losses.

Capital Assets

Capital assets, which include land, buildings, equipment and infrastructure assets (e.g., roads, bridges, ramps, and similar items), are reported in the government-wide statements and applicable fund financial statements. Capital assets that are used for governmental activities are only reported in the government-wide statements. Capital assets are reported at historical cost or, if donated, at the estimated fair market value at the date of acquisition. In some instances, capital asset historical costs were not available; therefore, the costs of these assets at the dates of acquisitions have been estimated.

Interest incurred during construction is only capitalized in proprietary funds. Most capital assets are depreciated over their useful lives, using the straight-line depreciation method. However, the State's significant infrastructure assets utilize an alternative accounting treatment in which costs to maintain and preserve these assets are expensed and no depreciation expense is recorded. This approach is discussed further in the Required Supplementary Information portion of this report.

Additional disclosures related to capital assets and assets acquired through capital leases are provided in Notes 9 and 11, respectively.

Warrants Outstanding

Warrants outstanding represent drafts issued against the State Treasurer's Common Cash pool, which have not yet cleared. These are similar to outstanding checks; however, the issuing funds' balances in the pool are not reduced until warrants are redeemed.

Income Tax Refunds Payable

The amount of collected or accrued personal income tax revenues that will be refunded is estimated and accrued as a General Fund liability. Note 15 more fully describes this liability.

Prize Awards Payable

The State Lottery Fund makes long-term prize awards for certain games, most notably the lotto games. At September 30, 2005 long-term prize awards of \$527.3 million were reported at a present value of \$371.9 million, using discount rates ranging from 5.0 to 8.5%.

Non-installment prize awards and the portion of long-term awards payable during the next fiscal year, totaling \$131.7

million, are included with "Accounts payable and other liabilities" on the Statement of Net Assets.

Deferred Revenue

In the government-wide statements and proprietary fund financial statements deferred revenue is recognized when cash, receivables, or other assets are received prior to their being earned. In the governmental fund statements deferred revenue is recognized when revenue is unearned or unavailable.

Long-Term Liabilities

In the government-wide statements and proprietary fund financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of the debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds, are reported as debt service expenditures.

Long-term liabilities are more fully described in Notes 12, 13, and 14.

Compensated Absences

In the government-wide statements and proprietary fund financial statements, compensated absences are reported as liabilities as required by GASB.

Employees accumulate annual leave (vacation) balances to maximum amounts ranging from 256 to 316 hours. They receive a 100% termination payment upon separation based upon their final rate of pay. The liability for annual leave is valued at 100% of the balance plus the State's share of social security and retirement contributions.

Employee sick leave balances accumulate without limit. Termination payments are made only upon separation from State service and only to employees hired prior to October 1, 1980. Payments at retirement or death are based on 50% of the employee's sick leave accumulation, times their last rate of pay. When separating for any other reason, employees are paid a percentage of their unused sick leave that increases from 0 to 50%, depending upon the balance of their sick leave hours. Sick leave is valued at 0 to 50% plus the State's share of social security contributions, based on the pay rates in effect as of September 30, 2005.

The State instituted a banked leave time program in fiscal year 2003-2004 whereby eligible employees work a regular schedule but receive pay for a reduced number of hours. The banked leave time program was continued in fiscal year 2004-2005. The unpaid hours worked accrue to a banked leave time account. Upon an employee's separation, death, or retirement from State service, unused banked leave time hours shall be contributed by the State to the employee's account within the State's 401k plans, and if applicable to the State's 457 plans. The banked leave liability is valued at the pay rates in effect as of September 30, the fiscal year-end.

In the governmental fund financial statements, liabilities for compensated absences are accrued when they are considered "due and payable" and recorded in the fund only for separations or transfers that occur before year-end.

Net Assets/Fund Balance

The difference between fund assets and liabilities is "Net Assets" on the government-wide, proprietary, and fiduciary fund statements, and "Fund Balance" on governmental fund statements.

Reservations

Fund balances for governmental funds are classified as either reserved or unreserved in the fund financial statements. Reserved fund balances reflect either: 1) funds legally segregated for a specific use, or 2) assets which, by their nature, are not available for expenditure. Unreserved fund balances reflect the balances available for appropriation for the general purposes of the fund. Note 21 provides a disaggregation of reserved fund balances.

F. Revenues and Expenditures/Expenses

Government-Wide Financial Statements

In the government-wide Statement of Activities, revenues and expenses are segregated by activity (governmental or business-type), then further by function (e.g., general government, education, transportation, etc). Additionally, revenues are classified between program and general revenues. Program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues, rather than as program revenue. General revenues include all taxes. Certain indirect costs are included in the program expenses reported for individual functions.

Interest on Long-Term Debt

Interest charges on the State's general long-term liabilities do not qualify as a direct expense of a function and are reported on this line, unless the borrowing is essential to the creation or continuing existence of a program. During fiscal year 2004-2005, interest charges on general long-term liabilities totaling \$17.4 million were reported as functional expenses.

Fund Financial Statements

In the governmental fund financial statements, revenues are reported by source. For budgetary control purposes, revenues are further classified as either "general purpose" or "restricted." General purpose revenues are available to fund any activity accounted for in the fund. Restricted revenues are, either by State law or by outside restriction (e.g., federal grants), available only for specified purposes. Unused restricted revenues at year-end are recorded as reservations of fund balance. When both general purpose and restricted funds are available for use, it is the State's policy to use restricted resources first.

In the governmental fund financial statements, expenditures are reported by character: "Current," "Capital outlay," "Intergovernmental-revenue sharing," or "Debt service." Current expenditures are subclassified by function and are for items such as salaries, grants, supplies, and services. Tax expenditures, which represent income tax credit programs that are in substance grants, are also reported as current expenditures. These are described in more detail in Note 15.

Capital outlay includes expenditures for capital assets. Intergovernmental-revenue sharing accounts for the distribution of certain tax revenues that are shared with local units based upon constitutional and statutory requirements. Debt service

includes both interest and principal outlays related to bonds and payments on capitalized leases.

Revenues and expenses of proprietary funds are classified as operating or nonoperating and are subclassified by object (e.g., salaries, depreciation, and purchases for resale). Operating revenues and expenses generally result from providing services and producing and delivering goods. All other revenues and expenses are reported as nonoperating.

Other Financing Sources

These additions to governmental fund balances in the fund financial statements include resources and financing provided by bond proceeds, capital leases, and transfers from other funds.

Reimbursements

Reimbursements result when a fund originally making a disbursement receives resources from another fund to which the expenditure/expense is more properly attributable. For example, the State uses this method when the administrative costs of proprietary funds, discretely presented component units, or pension (and other employee benefit) trust funds are appropriated in the General Fund.

Interfund Services Provided and Used

When a sale or purchase of program-related goods and/or services between funds occurs, for a price approximating their external exchange value, the seller reports revenue and the purchaser expenditure or expense, depending upon the fund type.

Transactions between the primary government and a discretely presented component unit are generally classified as revenues and expenses, unless they represent repayments of loans or similar activities.

Other Financing Uses

These reductions of governmental fund resources in fund financial statements normally result from transfers to other funds.

G. Interfund Activity and Balances

Interfund Activity

As a general rule, the effect of interfund activity has been eliminated from the government-wide statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities (examples include the transfers of profits from the Liquor Purchase Revolving Fund to General Fund and the Lottery Fund to the School Aid Fund) and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column (examples include activities between the Department of Treasury [general government line] and the Department of Education [education line]). Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

In the fund financial statements, transfers represent flows of assets (such as goods or cash) without equivalent flows of assets in return or a requirement for repayment. In addition, transfers are recorded when a fund receiving revenue provides it to the fund which expends the resources. An example is gas taxes collected by the Department of Transportation but expended by the Department of Natural Resources.

Interfund Balances

Interfund receivables and payables have been eliminated from the Statement of Net Assets, except for the residual amounts due between governmental and business-type activities.

NOTE 2 – FUNDS AND COMPONENT UNITS BY CLASSIFICATION

The following table lists all of the funds and component units whose balances are reflected in this financial report.

Operating funds which are subject to annual appropriation and for

which budget and actual schedules are included in this report are identified by an “*”. For each fund or component unit listed, the SOMCAFR page number of the first financial statement for that fund or component unit is shown in parenthesis.

PRIMARY GOVERNMENT:

MAJOR FUNDS

Governmental:

General Fund* (p. 20)
Counter-Cyclical Budget and Economic Stabilization Fund* (p. 20)
School Aid Fund* (p. 20)

Proprietary:

State Lottery Fund (p. 26)
Michigan Unemployment Compensation Funds (p. 26)

NON-MAJOR FUNDS

Governmental:

Special Revenue Funds:

Transportation Related:

State Aeronautics Fund* (p. 108)
State Trunkline Fund* (p. 108)
Michigan Transportation Fund* (p. 108)
Comprehensive Transportation Fund* (p. 108)
Combined State Trunkline Bond Proceeds Fund (p. 109)
Combined Comprehensive Transportation Bond Proceeds Fund (p. 109)
Transportation Related Trust Funds (p. 109)

Conservation, Environment, and Recreation Related:

Game and Fish Protection Fund* (p. 118)
Michigan State Waterways Fund* (p. 118)
Marine Safety Fund* (p. 118)
Game and Fish Protection Trust Fund (p. 118)
State Park Improvement Fund* (p. 118)
Combined Recreation Bond Fund - Local Projects (p. 119)
Combined Environmental Protection Bond Fund (p. 119)
Michigan Nongame Fish and Wildlife Fund* (p. 119)
Forest Development Fund* (p. 119)
Michigan Underground Storage Tank Financial Assurance Fund (p. 119)
Bottle Deposits Fund (p. 119)

Regulatory and Administrative Related:

Michigan Employment Security Act – Administration Fund* (p. 128)
Safety Education and Training Fund* (p. 128)
State Construction Code Fund* (p. 128)
Homeowner Construction Lien Recovery Fund* (p. 128)
State Casino Gaming Fund* (p. 129)
Second Injury Fund (p. 129)
Silicosis, Dust Disease, and Logging Industry Compensation Fund (p. 129)
Self-Insurers' Security Fund (p. 129)
Utility Consumer Representation Fund (p. 129)

Other State Funds:

School Bond Loan Fund (p. 138)
Tobacco Settlement Trust Fund* (p. 138)
Michigan Merit Award Trust Fund* (p. 138)
Children's Trust Fund* (p. 139)
Assigned Claims Facility and Plan Fund (p. 139)
Military Family Relief Fund (p. 139)
Miscellaneous Special Revenue Funds (p. 139)

Debt Service Funds:

Combined State Trunkline Bond and Interest Redemption Fund (p. 148)
Combined Comprehensive Transportation Bond and Interest Redemption Fund (p. 148)
Recreation and Environmental Protection Bond Redemption Fund (p. 148)
School Loan Bond Redemption Fund (p. 149)
State Building Authority (p. 149)
Michigan Underground Storage Tank Financial Assurance Finance Authority (p. 149)

Capital Projects Funds:

Combined Recreation Bond Fund - State Projects (p. 154)
Advance Financing Funds (p. 154)
State Building Authority (p. 154)

Permanent Funds:

Michigan Natural Resources Trust Fund* (p. 158)
Michigan State Parks Endowment Fund* (p. 158)
Michigan Civilian Conservation Corps Endowment Fund* (p. 158)
Michigan Veterans' Trust Fund* (p. 158)

Proprietary:

Enterprise Funds:

Liquor Purchase Revolving Fund (p. 164)
Attorney Discipline System (p. 164)

Internal Service Funds:

Correctional Industries Revolving Fund (p. 168)
Motor Transport Fund (p. 168)
Office Services Revolving Fund (p. 168)
Information Technology Fund (p. 169)
Risk Management Fund (p. 169)
State Sponsored Group Insurance Fund (p. 169)

Fiduciary:

Pension (and other employee benefit) Trust Funds:

State Employees' Deferred Compensation Funds (p. 176)
Legislative Retirement Fund (p. 176)
State Police Retirement Fund (p. 176)
State Employees' Retirement Fund (p. 177)
Public School Employees' Retirement Fund (p. 177)
Judges' Retirement Fund (p. 177)
State Employees' Defined Contribution Retirement Fund (p. 177)

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Private Purpose Trust Funds:

Escheats Fund (p. 182)
Gifts, Bequests, and Deposits Investment Fund (p. 182)
Hospital Patients' Trust Fund (p. 182)
Michigan Education Savings Program (p. 182)

Agency Funds:

Environmental Quality Deposits Fund (p. 185)
Insurance Carrier Deposits Fund (p. 185)
State Treasurer's Escrow and Paying Agent Fund (p. 185)
Child Support Collection Fund (p. 185)

DISCRETELY PRESENTED COMPONENT UNITS:

Authorities:

Major Funds:

Michigan Education Trust (p. 36)
Michigan State Housing Development Authority (p. 36)
Michigan Municipal Bond Authority (p. 36)

Non-Major Funds:

Land Bank Fast Track Authority (p. 190)
Mackinac Bridge Authority (p. 190)
Mackinac Island State Park Commission (p. 190)
Michigan Broadband Development Authority (p. 190)
Michigan Economic Development Corporation (p. 190)
Michigan Exposition and Fairgrounds Authority (p. 190)
Michigan Higher Education Assistance Authority (p. 191)
Michigan Higher Education Facilities Authority (p. 191)
Michigan Higher Education Student Loan Authority (p. 191)
Michigan Public Educational Facilities Authority (p. 191)
Michigan State Hospital Finance Authority (p. 191)
Michigan Strategic Fund (p. 191)
State Bar of Michigan (p. 191)

- (1) Michigan State University, the University of Michigan, and Wayne State University are not included in the State's reporting entity because they have separately elected governing boards and are legally separate from the State.

State Universities (1):

Major Funds:

Central Michigan University (p. 37)
Western Michigan University (p. 37)

Non-Major Funds:

Eastern Michigan University (p. 196)
Ferris State University (p. 196)
Grand Valley State University (p. 196)
Lake Superior State University (p. 196)
Michigan Technological University (p. 197)
Northern Michigan University (p. 197)
Oakland University (p. 197)
Saginaw Valley State University (p. 197)

The State provides significant funding to support these institutions; however, under GASB Statement No. 14 criteria, they are considered fiscally independent special-purpose governments.

NOTE 3 – BUDGETING, BUDGETARY CONTROL, AND LEGAL COMPLIANCE

A. Major Constitutional and Statutory Provisions

Balanced Budget Requirements

Article 5 of the State Constitution mandates that the executive budget recommend spending limits for operating funds to the Legislature that are within available resources. Compliance with this is demonstrated in the executive budget and budget bills for each fiscal year.

Article 4 of the State Constitution mandates the Legislature to enact appropriations for each operating fund that do not exceed that fund's revenue estimates, including beginning unreserved fund balance.

Compliance with this requirement is demonstrated in schedules included in the annual appropriation acts, usually the "General Government" appropriation act. When it appears that revenue will fall below the estimates on which the appropriations are based, the Governor is required to recommend spending reductions as necessary to avoid a year-end deficit.

Local Spending Requirements

Article 9, Section 30, of the State Constitution requires that State spending to, or on behalf of, local units of government shall not fall below a specified percentage of total State spending. The percentage, recalculated effective with fiscal year 1992-1993, is 48.97%.

Final calculations establishing the State's compliance with this constitutional provision for fiscal year 2004-2005 are not yet complete. For fiscal year 2003-2004, the most recent year for which final calculations are available, the proportion of total State spending paid to local units of government was determined to be 62.1%, reflecting payments that exceeded the minimum required by \$3.3 billion. The State expects that payments to local units of government will exceed the minimum requirement for fiscal year 2004-2005.

Revenue Limits

Article 9, Section 26, of the State Constitution restricts State revenues to a ceiling that is based upon revenues as a proportion of total personal income for the State. The base year ratio, determined in fiscal year 1978-1979, in relation to calendar year 1977 personal income, is 9.49%. Both the constitutional language and implementing statutes provide for other adjustments to the revenue and personal income calculations. If revenues exceed the limit by 1% or more, the amount in excess must be refunded to personal income tax payers and payers of the State's single business tax. If the limit is exceeded by an amount less than 1%, the excess may be deposited into the State's Budget Stabilization Fund. The calculations determining the State's compliance with this

constitutional provision for fiscal year 2004-2005 are not final. For fiscal year 2003-2004, the most recent year for which final calculations are available, total State revenues subject to this limitation were beneath the constitutional limit by \$4.4 billion. The State expects that total State revenues subject to the limitation will not exceed the limit for fiscal year 2004-2005.

Budget Stabilization Fund

The Counter-Cyclical Budget and Economic Stabilization Fund ("Budget Stabilization Fund") was created in 1977 to assist in stabilizing revenue during periods of economic recession. This fund currently operates under Article 3 of P.A. 431 of 1984, as amended. In general, the law requires payments into the fund when real economic growth exceeds 2% and allows withdrawals from the fund when real economic growth is less than 0%. Funds can also be withdrawn when the State's unemployment rate exceeds 8% or upon appropriation to finance capital outlay or other projects, or for other purposes designated by the Legislature.

The following table summarizes the transactions for the fund for fiscal year 2004-2005 (in millions):

Beginning unreserved fund balance	\$ 81.3
Interest Income	2.0
Transfer to General Fund	(81.3)
Ending unreserved fund balance	<u>\$ 2.0</u>

The transfer to the General Fund was pursuant to P.A. 188 of 2005, Section 353c (16). This transfer was made to ensure a balanced General Fund budget.

Budgetary Overexpenditures

In the event that expenditures exceed authorization during a year, the department must request a supplemental appropriation for the amount overspent, if that amount exceeds their lapses or if they expect to make payments from prior year authorization in the next fiscal year. There were the following line-item overexpenditures of State departments incurred during the year, which represent noncompliance with State budget laws (in millions):

General Fund	
Human Services	\$ 8.0
General Fund Total	<u>\$ 8.0</u>

NOTE 4 – ACCOUNTING CHANGES AND RESTATEMENTS

Reclassification of the Children's Trust Fund

The Children's Trust Fund, formerly reported as a permanent fund, was reclassified to the special revenue fund type because of legislative changes occurring during fiscal year 2004-2005 that impacted the amount required to be maintained in the fund and the amount available for appropriation.

The effect of this change as of October 1, 2004, was to decrease permanent fund current assets (\$11.7 million), long-term investments (\$14.3 million), current liabilities (\$4.2 million), and fund balances (\$21.8 million). Special revenue fund assets, liabilities, and fund balances were increased by like amounts.

Michigan Exposition and Fairgrounds Authority

Public Act 468 of 2004 created the Michigan Exposition and Fairgrounds Authority (MEFA), a discretely presented component unit. In previous years, the State reported state fair activities in a subfund of the General Fund. Net assets of \$.3 million were transferred from the General Fund to the MEFA, as well as capital

assets, accumulated depreciation, and compensated absences liabilities totaling \$15.7 million, \$6.7 million, and \$.1 million respectively which were previously reported in the primary government's portion of the Statement of Net Assets. This change has been reported as a beginning balance restatement.

Net Pension Obligation

The beginning balance of the net pension obligation, reported on the Statement of Net Assets line titled "Noncurrent portion of other long-term obligations," was reduced by \$24.3 million based on revised actuarial reports.

Capital Assets

Beginning balances were restated for capital assets to correct prior period errors in infrastructure and construction in progress. Infrastructure was increased by \$48.0 million; construction in progress was increased by \$31.6 million; and net assets invested capital assets, net of related debt was increased by \$79.5 million.

NOTE 5 – TREASURER’S COMMON CASH

A. General Accounting Policies

The State Treasurer manages the State's Common Cash pool, which is used by most state funds. The pooling of cash allows the Treasurer to invest monies not needed to pay immediate obligations so that investment earnings on available cash are maximized. Investments of the pool are not segregated by fund; rather, each contributing fund's balance is treated as equity in the pool, and presented in this report as "Equity in common cash." Many funds, including pension (and other employee benefit) trust funds, use their equity in the pool as a short-term investment vehicle.

All negative balances in the pool are reclassified at year-end as interfund liabilities. If the negative balance is considered long-term, the reclassification is recorded as an advance.

Statute or administrative policy determines whether a particular fund receives or pays interest on its balances in the pool. If a fund does not receive or pay interest, the General Fund receives or absorbs such amounts. Earnings on positive balances and charges on negative balances are allocated quarterly based upon the average daily balances of the various funds and the average investment earnings rate for the quarter. Accrued earnings of the pool are recorded as assets, with the accrual allocated to the various funds' equity in the pool.

Interest revenues on positive balances and interest charges on negative balances are reflected as revenues or expenditures/expenses of each of the participating funds.

B. Investments and Deposits

The investment authority for the Common Cash pool is found in P.A. 105 of 1855, as amended. The State Treasurer may invest surplus funds belonging to the State in the bonds, notes, and other evidences of indebtedness of the United States Government and its agencies and in prime commercial paper. Certificates of deposit are permitted in financial institutions whose principal office is located in the State.

The Treasurer invests excess cash in short-term investments (cash equivalents), mostly prime commercial paper. The law does not prohibit the Treasurer from entering into repurchase agreements; however, the Treasurer did not use these agreements in managing the pool in fiscal year 2004-2005.

Statutes provide for certain special state investment programs for which the General Fund is credited (charged) for earnings in excess of (under) those achieved by regular pool investments. There have been no principal losses because of these programs to date.

Emergency Financial Assistance Loan Program: This program provides for emergency loans to local units of government, and is the most significant of the special investment programs. The Emergency Financial Assistance Loan Board, established by P.A. 243 of 1980, administers the program. The Treasurer may not loan more than a combined total of \$5.0 million in any one fiscal year to qualifying cities, villages, or townships in amounts as approved by the Board.

In fiscal year 1999-2000 the Emergency Financial Assistance Loan Board was authorized to approve the lending of up to \$159.9 million to Wayne County to finance the payment of certain obligations to the State. The outstanding balance at September 30, 2005, was \$48.6 million. The interest rate is reset July 1 of each year in accordance with the loan

agreement. Loan repayments by the County are supported by provisions of the loan agreement and legislation that pledge the County's share of a portion of the State taxes collected on cigarette sales. There were no repayments on the loans in fiscal year 2004-2005.

Michigan Marina Dredging Loan Program: Public Act 280 of 2000 provides for a program under which financial institutions may make low-interest loans to eligible marinas for dredging costs necessitated by low water levels to accommodate the use of the marina by recreational watercraft.

Under this program, the Department of Treasury and a financial institution may enter into an investment agreement under which the Department of Treasury will invest the State's Common Cash with the financial institution at an agreed upon interest rate (generally 1.5 percent per annum). The financial institution will then use the principal to make a low-interest loan to an eligible marina.

The Act specifies that the maximum amount of a Michigan marina-dredging loan is \$75 thousand per marina. The total amount of outstanding loans is statutorily limited to \$20.0 million. The loans accrue interest at a rate of six percent, and the loans' terms may not exceed seven years. Other details about the loans are available in the investment agreement. The total amount on loan at September 30, 2005, was \$127.5 thousand; repayments during the year were \$73.2 thousand.

Michigan Sugar Beet Loan Program: Public Act 123 of 2001 provides for a program in which the State may make no-interest loans from the Common Cash pool to sugar beet growers' cooperatives for the purpose of buying the assets of agricultural processors who are in or have recently been in bankruptcy proceedings.

The Act specifies that the loans may not exceed \$5.0 million in total, with loan periods not to exceed 5 years. As of September 30, 2005, the loans outstanding totaled \$4.5 million and mature on February 1, 2007.

Public Act 342 of 2004 requires the State Treasurer, as part of the modification to the loan, to subordinate a loan of not more than \$5.0 million to the primary loan of a sugar beet growers' cooperative (Michigan Sugar Beet Growers, Inc.) and relinquish any enforcement powers or authority that may exist under the current contract or agreement.

Agriculture Disaster Relief Program: Public Act 16 of 2002 created this program to provide loans to assist farmers and businesses suffering losses as a result of a disaster. Financial institutions (banks) making these loans can have the cost of the loan covered by (1) earnings on funds deposited by the State, or (2) a subsidy of the cost.

The maximum loan is \$150 thousand (\$200 thousand under certain circumstances) to farmers and \$400 thousand per legal entity to businesses. The total amount the State may deposit under this program is \$30.0 million. Of that amount, no more than \$10.0 million may be allocated to qualified agricultural loans made to businesses. Details on what constitutes a qualified loan can be found in the statute. Loans must be made before October 1, 2002, and must be repaid by October 1, 2007.

As of September 30, 2005, the State had deposited a total of \$2.9 million with three different financial institutions. Subsidy payments totaled \$3.2 million and repayments totaled \$37.9 million.

Assets and equities of the Common Cash pool as of September 30 were as follows (in millions):

Michigan
Notes to the Financial Statements

Assets

Cash on hand	\$ -
Demand deposits	238.5
Time deposits - regular	-
Time deposits - Marina Loan Programs	.1
Time deposits - Agricultural Loan Program	2.9
Prime commercial paper - at cost	1,237.3
Interest receivable	1.6
Emergency loans to local units - at cost	49.6
Michigan Sugar Beet Loan Program	4.5
Total assets	<u>\$ 1,534.6</u>

Equities

Fund equities (net) in Common Cash (1):	
Governmental activities	\$ 1,122.5
Business-type activities	71.0
Fiduciary funds	233.6
Discretely presented component units	107.4
Net fund equities	<u>\$ 1,534.6</u>

(1) Negative equity balances in the pool are reclassified at year-end as interfund receivables and liabilities. Current balances are included with "Amounts due from other funds" and "Amounts due to other funds" and long-term amounts are classified as interfund advances. Note 17 summarizes interfund receivables and liabilities.

The following paragraphs provide disclosures about deposits and investments of the Common Cash pool, as required by GASB Statement No. 3 as amended by Statement No. 40. Please see Note 8 for information about deposits and investments that are not part of the Common Cash pool.

C. Common Cash Deposits

Custodial Credit Risk

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the State's deposits may not be recovered.

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are:

Uncollateralized

Collateralized with securities held by the pledging financial institution, or

Collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name.

The State Treasurer's policy requires the following criteria to lessen the custodial credit risk: all financial institutions holding the State's money must pledge collateral equal to the amount of the account balance for all demand and time deposits, to secure the State funds. A bank, savings and loan association or credit union holding State funds must be organized under the law of Michigan or federal law and maintain a principal office or branch office in the State of Michigan. No deposit in any financial organization may be in excess of 50 percent of the net worth of the organization.

At September 30, 2005, the carrying amount of deposits, including time and demand deposits, was \$241.6 million. The deposits were reflected in the accounts of the banks at \$241.6 million. Of the bank balance, \$4.3 million was covered by federal depository insurance, \$236.8 million was collateralized with securities held by the State's agent in the State's name,

and \$.5 million of demand deposits was exposed to custodial credit risk and was uninsured and uncollateralized. Compensating balances kept in demand deposit accounts to avoid service charges totaled \$164.2 million at September 30, 2005.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of deposits.

Public Act 35 of 1997 requires State deposits be held in a financial institution which maintains a principal office or branch office located in the State of Michigan. The State had no Common Cash deposits subject to foreign currency risk at September 30, 2005.

D. Common Cash Investments

Types of Investments

Common Cash investments include prime commercial paper, corporate notes, and emergency municipal loans.

Risk

In accordance with GASB Statement No. 40, investments also require certain disclosures regarding policies and practices with respect to the risks associated with them. Custodial credit risk, credit risk, and interest rate risk are discussed in the following paragraphs.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the State will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government and are held by either:

The counterparty, or

The counterparty's trust department or agent but not in the government's name.

The State Treasurer does not have an investment policy for managing custodial credit risk. At September 30, 2005 Common Cash investments were not exposed to custodial credit risk.

Credit Risk

Credit risk is the risk that an issuer or another counterparty to an investment will not fulfill its obligations.

Prime commercial paper investments must be rated A-1 or P-1 at the time of purchase as rated by the two major rating services Standard and Poor's (A-1), and Moody's (P-1). Borrowers must have at least \$400.0 million in commercial paper outstanding, and the State Treasurer may not invest in more than 10% of a borrower's outstanding debt. The investments are further limited to \$200.0 million in any borrower, unless the borrower has an A-1+ rating, in which case the investment is not to exceed \$300.0 million. The sugar beet loans are evidenced by unrated zero interest promissory notes.

Emergency municipal loans are evidenced by unrated notes held by the State in the State's name. At September 30, 2005, prime commercial paper investments were rated at A-1 or P-1.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

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Notes to the Financial Statements

The State Treasurer's policy states that cash equivalents are invested in short-term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk. At September 30, 2005, the fair value of prime commercial paper was \$1.2 billion; the weighted average maturity was 14 days.

The State Treasurer does not have a policy for controlling interest rate risk regarding the Common Cash special loan

programs described earlier. These loan programs are investments created through legislation. Although some interest rate risk exposure exists, this risk is not a consideration when entering into these loan programs.

NOTE 6 – TAXES RECEIVABLE

Taxes receivable represent amounts due to the State at September 30, for revenues earned in fiscal year 2004-2005, which will be collected sometime in the future. Amounts expected to be collected in the next fiscal year are classified as “current” and amounts expected to be collected beyond the next fiscal year are classified as “noncurrent.” The receivables have been recorded net of allowances for uncollectibles.

Sales, use, single business, and income taxes are accrued to the extent that the related sales, wage, or activity being taxed occurred prior to October 1. Property taxes are accrued if the levy date occurred prior to October 1.

In the government-wide financial statements, a corresponding amount is recorded as revenue using the accrual basis of accounting. In the governmental fund financial statements, revenue

is recorded using the modified accrual basis of accounting for amounts due to the State at September 30 (as stated above) that are considered “available” (e.g. received by the State within approximately 60 days after that date). Delinquent taxes are recognized to the extent that they are collected within 12 months. The remainder is recorded as deferred revenue.

Local units of government, as agents for the State, assess the State education tax, a state-wide property tax. The State education tax is levied on July 1 and is due and payable at the same time as local unit taxes levied on July 1. The State accrues state education tax revenue received by the State or the local units, on its behalf, during October and November. The accrued telephone and telegraph taxes are due December 1 and were received at approximately that time.

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Notes to the Financial Statements

Taxes receivable as of September 30, consisted of the following
(in millions):

<u>Tax</u>	General Fund	Special Revenue Funds	Total
Sales & use	\$ 333.4	\$ 661.7	\$ 995.1
Individual income	1,654.2	203.2	1,857.5
Single business	1,559.8	-	1,559.8
State education (property)	-	1,371.6	1,371.6
Telephone & telegraph	49.0	-	49.0
Motor fuel	-	229.1	229.1
Insurance - retaliatory	70.8	-	70.8
Estate & inheritance	4.3	-	4.3
Tobacco products	101.6	68.1	169.7
Quality assurance assessment	70.7	-	70.7
Other	35.7	50.5	86.1
Penalties and interest	1,146.3	-	1,146.3
Gross taxes receivable	5,025.7	2,584.2	7,609.9
Less allowance for uncollectibles	2,053.3	458.0	2,511.3
Total taxes receivable (net)	<u>\$ 2,972.4</u>	<u>\$ 2,126.1</u>	<u>\$ 5,098.6</u>
<u>As reported on the financial statements</u>			
Current taxes receivable	\$ 2,737.9	\$ 2,077.0	\$ 4,814.9
Noncurrent taxes receivable	234.5	49.1	283.7
Total taxes receivable (net)	<u>\$ 2,972.4</u>	<u>\$ 2,126.1</u>	<u>\$ 5,098.6</u>

NOTE 7 – JOINT VENTURES

The State participates in two joint ventures as described below. Joint ventures are not reflected as component units within this report because they do not meet the GAAP criteria for inclusion. Their separately issued financial statements may be obtained by directly contacting the applicable organizations. To obtain their phone numbers, you may contact the Office of the State Budget, Office of Financial Management, Financial Reporting Section at (517) 373-3029.

Great Lakes Protection Fund (GLPF)

GLPF is a not-for-profit corporation located in Evanston, Illinois. Its purpose is to finance and support research with respect to water quality of the Great Lakes. The eight states bordering the Great Lakes are eligible to become members if they make a required contribution to the endowment of GLPF.

Contribution requirements were established based upon water consumption and usage. Contributions to GLPF are permanently restricted and are not available for disbursement. Michigan is the largest contributor, having made a contribution of \$25.0 million, constituting approximately 31% of the total. Michigan made its required contribution by issuing GLPF a general obligation bond authorized as part of the State's environmental protection bond program. No additional contributions from Michigan will be required.

Two members on GLPF's board of directors represent each of the participating seven member states. The states' respective governors select the board members. Directors control GLPF's financing and budgeting operations, within requirements established by the Articles

of Incorporation. One-third of the net earnings on total contributions (after operating expenses) is granted to the respective states in proportion to their contributions to GLPF. Two-thirds of the net earnings are available to GLPF to make other grants. The State's equity interest in GLPF of \$25.0 million is reflected as an asset in the government-wide statements.

Joint International Bridge Authority

The International Bridge in Sault Ste. Marie, Michigan is a joint venture of the State and Canadian governments. The Authority consists of six people, three appointed by each government. The Authority oversees the operations and maintenance of the Bridge. The International Bridge Administration, an administrative entity within the Michigan Department of Transportation, is responsible for the day-to-day operations of the Bridge. The Authority reimburses the State for costs incurred to provide these services.

For the period ending December 31, 2004 (the Authority's most recently audited financial statements), its net assets increased by approximately \$.8 million. The Bridge and the ancillary assets on Michigan's side of the Bridge, in addition to one-half of the balance of funds not required to pay liabilities, represent the State's equity interest. The State is obligated to pay one-half of any claims incurred by the Authority that are not covered by insurance or existing resources. The State's equity interest of \$6.9 million is reflected as an asset in the government-wide statements.

NOTE 8 – DEPOSITS AND INVESTMENTS

This note provides information for all deposits and investments except those of the Common Cash pool, which are described in Note 5.

A. Deposits - Primary Government

Custodial Credit Risk

In addition to equity in the Common Cash pool, some State funds maintain deposits with financial institutions. At present, only the Michigan Unemployment Compensation Funds (MUCF), the State Treasurer's Escrow and Paying Agent Fund, and the Michigan Educational Savings Plan maintain these deposits and are exposed to custodial credit risk.

The Michigan Employment Security Commission (MESC) administers, under the auspices of the federal government, the deposits of the MUCF. Tax collections are deposited in a clearing account as required by the Michigan Employment Security Act. Refunds are paid from that account; after the clearance of vouchers for refunds, all other money remaining in the fund, less amounts needed for refunds and judgments, must be deposited with the secretary of the treasury of the United States of America to the credit of the State in the Unemployment Trust Fund, established and maintained pursuant to Section 904 of the Social Security Act, 42 USC 1104. These deposits are maintained in the Federal Reserve Bank. At year-end, the carrying amount of these deposits, excluding those classified as investments, was negative \$9.4

million, which was caused by a net book cash overdraft. The bank balance of the deposits was \$15.9 million, of which \$.1 million was covered by federal depository insurance and \$15.8 was book-entry securities held by pledging custodial banks at the Federal Reserve Bank in the State's name.

The deposits of the State Treasurer's Escrow and Paying Agent Fund were reflected in bank accounts at \$1.6 million; these deposits were uninsured and uncollateralized, and were therefore exposed to custodial credit risk. This fund was administratively created and is used to account for investments held in escrow by the State Treasurer as fiscal agent for hospitals that have defeased Michigan State Hospital Finance Authority (MSHFA) bonds. MCL 331.73g(1) allows that the deposits shall be held in trust by the State Treasurer or by a financial institution qualified to serve as trustee pursuant to a trust agreement entered into between the authority issuing the refunding bonds and the State Treasurer or the financial institution providing for the investment and disposition of the funds.

The deposits of the Michigan Educational Savings Program were reflected in bank accounts at \$.6 million; \$.1 million was insured and \$.5 million was exposed to custodial credit risk. The program has no policy for controlling this risk.

B. Investments - Primary Government

The following table shows the carrying amounts and fair values of investments of the primary government by investment type and in total (in millions) at September 30, 2005:

Primary Government Total Investments (In millions)				
Investment Types	Pension Funds	Deferred Compensation/ Defined Benefit Funds	Other Funds	Total
Commercial paper	\$ 2,774.2	\$ -	\$ -	\$ 2,774.2
Government securities	4,031.8	-	1,466.9	5,498.6
Money market accounts	-	-	210.6	210.6
Money market funds	-	182.7	42.6	225.3
Corporate bonds and notes	4,105.9	-	132.8	4,238.7
Mutual funds	105.7	1,885.2	875.7	2,866.6
Pooled investment funds	-	1,916.9	-	1,916.9
Equities	24,374.5	-	150.7	24,525.2
Guaranteed investment contracts	-	-	6.0	6.0
Funding agreements	-	-	150.5	150.5
International	6,160.5	-	-	6,160.5
Real estate	3,842.5	-	-	3,842.5
Alternative	5,807.8	-	-	5,807.8
Accrued income	125.8	-	-	125.8
Cash collateral	(174.4)	-	-	(174.4)
Unsettled investments	(54.6)	-	-	(54.6)
Total	\$ 51,099.8	\$ 3,984.8	\$ 3,035.8	\$ 58,120.3
As reported on the Statement				
Of Net Assets				
Current investments	\$ 936.8			
Noncurrent investments	972.8			
Total Investments	\$ 1,909.6			

Michigan
Notes to the Financial Statements

As reported on the Statements of Net Assets and Statement of Fiduciary Net Assets

	Current Investments	Noncurrent Investments	Total
Governmental Activities	\$ 210.6	\$ 551.9	\$ 762.5
Business-type activities	726.2	420.9	1,147.1
Fiduciary funds	1,786.1	54,424.6	56,210.7
Total Investments	<u>\$ 2,723.0</u>	<u>\$ 55,397.4</u>	<u>\$ 58,120.3</u>

Authority

Investment authority for the State's pension (and other employee benefit) trust funds is found in P.A. 314 of 1965, as amended. This act allows the State Treasurer, as investment fiduciary, to make diverse investments in stocks, corporate and government bonds and notes, mortgages, real estate, venture capital, and other investments. The act has prudence standards and requires that the assets of a retirement system shall be invested solely in the interest of the participants and beneficiaries, and be made for the exclusive purpose of providing benefits to the participants and the participants' beneficiaries, and of defraying reasonable expenses of investing the assets of the State system.

The investment authority for other State funds is found in their enabling statutes and/or their bond resolutions where applicable. Except as noted below, the investments of the non-pension (and other employee benefit) trust funds are comprised mostly of United States government securities.

The State Building Authority makes diverse investments as allowed by State statute and/or bond resolutions.

Investments of MUCF represent their interest in a U.S. Treasury trust fund managed by the Secretary of the Treasury pursuant to Title IX of the Social Security Act, which includes deposits from the unemployment compensation funds of various states. MUCF is credited quarterly with trust fund investment earnings, as computed on a daily basis.

The deferred compensation plans are invested in mutual funds, U.S. Treasury strips, money market funds, and pooled investment funds. During fiscal year 2004-2005, the deferred compensation plans' investment activities were managed by a private investment firm, which invests as directed by members of the plan.

Derivatives

The State Treasurer is also authorized to invest a limited amount of pension (and other employee benefit) trust funds in futures contracts. Such investments were made in Standard & Poor's 500 and Standard & Poor's Midcap Index futures contracts during the year. At September 30, 2005, there was \$174.8 million invested in futures contracts. Derivatives are used for a small amount of the pension (and other employee benefit) trust fund portfolios to provide additional diversification. However, derivatives are not used for speculation and they are not used to leverage the investment portfolios. Approximately 10% of the total pension (and other employee benefit) trust funds portfolio has been invested from time to time in futures contracts and swap agreements. The swap agreements provide that the retirement systems will pay quarterly, over the term of the swap agreements, interest indexed to the three month London Interbank Offered Rate (Libor), adjusted for an interest rate spread, on the notional amount stated in the agreements. United States domestic Libor-based floating rate notes were purchased in the open market to correspond with the notional amount of the swap agreements. The State Treasurer maintains custody and control of these notes. Swap

agreements represent the largest category of derivatives used and total approximately 10.0% of the total portfolio.

Investment Pools

In July 2004, four state retirement systems' (State Employees', State Police, Public School Employees', and Judges') investments were contributed to an investment pool structure. A pro rata share of the entire pool represents each system's ownership of a portion of the investments in the State's pool.

Repurchase Agreements

As a matter of administrative policy, the State Treasurer makes only limited use of investments in repurchase agreements. No such investments were outstanding at year-end.

Risk

GASB Statement No. 40 requires certain disclosures regarding policies and practices with respect to the risks associated with investments. The custodial credit risk, the credit risk, the interest rate risk, the foreign currency risk and concentration of credit risk are discussed in the following paragraphs.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, the State will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government and are held by either the counterparty, or the counterparty's trust department or agent, but not in the government's name.

The State Treasurer does not have a policy for limiting custodial credit risk. As of September 30, 2005, government securities with a market value of \$50.0 million were exposed to custodial credit risk. These securities were held by the counterparty, not in the name of the retirement systems.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Short-term investment for the pensions funds are in prime commercial paper and follow the same policy described in Note 5 for this type of investment. The ratings at September 30 are included in the rated debt investment table.

All long-term fixed income investments, unless unrated, must be investment-grade at the time of purchase. Investment grade, as defined in P.A. 314 of 1965, as amended, includes: investments in the top four major grades, rated by two national rating services. The State Treasurer's policy is to use Standard & Poor's (AAA, AA, A, BBB); and Moody's (Aaa, Aa, A, Baa). The primary government's rated debt investments as of September 30, 2005, are presented below. Note that securities backed by the full faith and credit of the United States Government are excluded.

Michigan
Notes to the Financial Statements

	Debt Investments (In millions)			
Investment Type	Fair Value	Rating S & P	Fair Value	Rating Moody's
Pension (and Other Employee Benefit) Trust Funds:				
Retirement Systems:				
Commercial paper	\$ 2,191.5	A-1	\$ 2,400.9	P-1
	99.4	A-2	99.4	P-2
	483.2	Unrated	273.9	Unrated
Government securities				
U.S. agencies – sponsored	2,499.1	AAA	2,499.1	Aaa
Corporate bonds & notes	698.6	AAA	698.6	Aaa
	951.6	AA	1,131.4	Aa
	1,681.8	A	1,475.2	A
	393.2	BBB	495.4	Baa
	316.7	BB	140.0	Ba
	64.0	Unrated	165.2	Unrated
International*	859.7	AAA	859.7	Aaa
	984.8	AA	1,684.7	Aa
	2,059.5	A	1,329.6	A
	100.0	BB	100.0	Ba
			30.0	Unrated
Equity*	50.0	AA	100.0	Aa
	50.0	A	-	-
Mutual funds	68.5	Unrated	68.5	Unrated
Total	13,551.7		13,551.7	
Deferred Compensation/Defined Contribution:				
Common trust funds	\$ 1,053.1	AAA	\$ 1,060.6	Aaa
	269.9	AA	269.9	Aa
	20.0	Unrated	12.4	Unrated
Mutual funds	53.1	AA	53.0	Unavailable
Money market funds	182.7	AI	182.7	Unavailable
Total	1,578.7		1,578.7	
Other Primary Government Funds:				
Government securities				
U.S. agencies – sponsored	\$ 259.6	AAA	\$ 259.6	Aaa
	6.8	Unrated	6.8	Unrated
Corporate bonds & notes	69.4	AAA	75.0	Aaa
	15.2	AA	-	-
	45.2	A	57.8	A
	3.0	BBB	-	-
Guaranteed investment contract	6.0	Unrated	6.0	Unrated
Mutual funds	212.8	AAA	212.8	Unavailable
	69.4	AA	69.4	Unavailable
	1.9	Unrated	1.9	Unrated
Treasury trust fund pool	631.0	Unrated	631.0	Unrated
Total	1,320.2		1,320.2	
Total Primary Government	\$ 16,450.6		\$ 16,450.6	

*International and Equity Investment types consist of domestic floating rate notes that are used as part of a Swap strategy.

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Notes to the Financial Statements

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of those investments.

The State Treasurer's policy states that cash equivalents are invested in short term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk. At September 30, 2005, the fair value of prime commercial paper was \$2.8 billion; the weighted average maturity was 38 days.

The State Treasurer does not have a policy regarding interest rate risk for long-term debt investments. However, the pension

trust funds are invested with a long-term strategy with no investments with a maturity of less than one year at the time of purchase. The goal is to balance higher returns while accepting minimum risk for the return. Analyzing the yield curve on individual securities as compared to U.S. Treasuries determines, in part, what is an acceptable risk for the return. Therefore, market conditions such as lower interest rates result in shorter duration; higher interest rates result in longer duration.

As of September 30, 2005, the pension trust funds had the following long-term debt securities:

Pension (and Other Employee Benefit) Trust Funds Debt Securities (In millions)		
	Fair Value	Duration In Years
Retirement Systems:		
Governmental		
U.S. Treasury	\$ 398.3	4.3
U.S. Agency - Backed	1,134.3	5.3
U.S. Agency - Sponsored	2,499.1	2.5
Total Government	4,031.8	
Corporate	4,105.9	4.1
International*		
U.S. Agency - Sponsored	50.0	.1
Corporate	3,954.1	.2
Total International	4,004.1	
Equities*	100.0	.2
Mutual fund - fixed income	68.5	4.4
Total	<u>\$12,310.1</u>	
Deferred Compensation/Defined Benefit:		
Common trust funds		
Traditional GIC/BICs	\$ 199.9	1.4
Buy and hold synthetics	43.3	1.9
Global wrap synthetic contracts	1,029.8	3.1
SSgA daily bond market index fund	70.1	4.4
Money market funds	182.7	.1
Mutual fund	53.0	5.1
Total	<u>1,578.7</u>	
Total Pension (and Other Employee Benefit) Trust Funds	<u><u>\$13,888.9</u></u>	

*International and Equities contain Domestic Government and Corporate Securities as a part of their derivative strategies. The interest rates reset on a quarterly basis for these securities.

For the other primary government funds, fixed income is invested in a laddered, time-segmented structure allowing for intermittent cash flows as needed.

As of September 30, 2005, the primary government, excluding pension trust funds, had the following long-term debt securities:

Michigan
Notes to the Financial Statements

Other Funds Debt Securities (In millions)					
Investment Type	Fair Value	Investment Maturities (In Years)			
		Less Than 1	1 To 5	6 To 10	More Than 10
U.S. Treasury SLGS	\$ 44.8	\$ 11.1	\$ 33.8	\$ -	\$ -
U.S. Treasury bonds	514.3	93.4	261.1	126.8	33.0
U.S. Bonds - backed	10.4	-	.4	1.6	8.4
U.S. Agency bonds - sponsored	266.4	-	28.7	173.9	63.8
Corporate bonds	132.8	-	25.15	57.9	49.8
Guaranteed investment contracts	6.0	-	6.0	-	-
Mutual funds	284.0	1.9	-	212.8	69.4
Total	\$ 1,258.8	\$ 106.3	\$ 355.0	\$ 573.1	\$ 224.4

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments or deposits.

The pension trust funds invest in various foreign securities. These investments are limited to 20% of the total assets of the system, and are additionally limited to 5% of the outstanding foreign securities of any single issuer. No investment is allowed in a country that has been identified by the United States State

Department as engaging in or sponsoring terrorism. These limits are set forth in P.A. 314 of 1965, as amended. The types of foreign securities include equities, fixed income, mutual funds, and limited partnerships. At September 30, 2005, foreign investments were less than 5% of total assets of the systems; total foreign investments were \$2.3 billion. As of September 30, 2005, the pension (and other employee benefits) trust funds held the following investments subject to foreign currency risk:

Pension (and Other Employee Benefit) Trust Funds
Foreign Currency Risk
(In millions)

Currency	Country	Market Value (In U.S. Dollars)							
		Alternative Investments	Equities	Equities - International					
				Equities	Derivatives*				
Retirement Systems:									
Americas									
Real	Brazil	\$	-	\$.4	\$	-	\$	-
Peso	Mexico		-		260.1		-		-
Europe									
Euro	European Union		338.9		1.4		67.9		168.7
Franc	Switzerland		-		32.2		-		25.8
Krona	Sweden		-		-		.4		15.0
Krone	Denmark		-		-		1.6		9.3
Krone	Norway		-		-		1.8		9.0
Sterling	United Kingdom		29.8		177.1		41.6		94.1
Asia/Pacific									
Dollar	Australia		-		-		.4		42.1
Dollar	Hong Kong		-		-		6.1		11.3
Yen	Japan		8.6		-		4.5		128.2
Dollar	New Zealand		-		-		-		1.9
Won	Singapore		-		-		-		6.3
Won	South Korea		-		-		-		24.7
Mutual Funds									
Various	Various		-		20.3		757.7		-
Total			\$ 377.3		\$ 491.5		\$ 882.0		\$ 536.2
Deferred Compensation/Defined Contribution:									
Mutual Funds									
Various	Various		\$ -		\$ 302.0		\$ -		\$ -
Total			\$ 377.3		\$ 793.5		\$ 882.0		\$ 536.2

Michigan
Notes to the Financial Statements

*International derivatives' market value exposure to foreign currency risk is the net amount of unrealized gains and unrealized losses. Maturity dates on these investments range from October 2005 through September 2008, with an average maturity of 1.5 years. For more information, see the derivatives section of this note.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributable to the magnitude of a government's investments with a single issuer.

Other than obligations issued that are assumed or guaranteed by the United States, its agencies, or United States government-sponsored enterprises, the pension systems are prohibited by P.A. 314 of 1965, as amended, from investing in more than 5% of the outstanding obligations of any one issuer or investing more than 5% of a system's assets in the obligations of any one issuer.

At September 30, 2005, there were no investments in any single issuer more than 5% of the system's assets, nor were there any investments totaling more than 5% of the obligations of any one issuer, other than U.S. Government Securities as described above.

Pension trust fund investments represent 94.8% of the total investments of the primary government. Other large holders of investments were the State Lottery Fund and MUCF.

The State Lottery Fund investments, \$514.3 million, are all in the form of zero coupon U.S. Treasury bonds. These investments are held to provide funding for deferred prize awards.

Securities Lending Transactions

Under the authority of P.A. 314 of 1965, the State lends securities to broker-dealers and other entities for collateral that will be returned for the same securities in the future. The custodian is not liable for any losses unless there is negligence or willful misconduct on its part. State statutes allow the State to participate in securities lending transactions, via a Securities Lending Authorization Agreement, authorizing the agent bank to lend its securities to broker-dealers and banks, pursuant to a form of loan agreement. During the fiscal year, the agent bank, at the direction of the State Treasurer, lent securities and received: cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated A or better, convertible bonds, Canadian provincial debt, and irrevocable bank letters of credit as collateral. The agent bank did not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers were required to deliver collateral for each loan equal to: 1) in the case of loaned securities denominated in United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments, 102% of the market value of the loaned securities; or 2) in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States, 105% of the market value of the loaned securities.

The State Treasurer did not impose any restrictions during the fiscal year on the amount of the loans that the agent bank made

on its behalf. The agent bank indemnified the State by agreeing to purchase replacement securities, or return cash collateral in the event the borrower failed to return the loaned securities or pay distributions thereon. There were no such failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or the agent bank.

During the fiscal year, the State Treasurer and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested in a collective investment pool along with the cash collateral of other qualified and non-qualified tax-exempt plan lenders. As of September 30, 2005, the investment pool had an average duration of 45 days and an average expected maturity of 404 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. At September 30, 2005, the retirement systems had no credit risk exposure to borrowers. The collateral held and the market value of securities on loan for the State as of September 30, 2005, were \$3.4 billion and \$3.3 billion, respectively.

C. Deposits and Investments - Discretely Presented Component Units

Deposits

At year-end, the carrying amount of discretely presented component units deposits, excluding those classified as investments, was \$158.4 million. The deposits were reflected in the accounts of the banks at \$164.9 million. Of the bank balance, \$143.9 million was uninsured and uncollateralized and therefore exposed to custodial credit risk.

Investments

The investment authority for most discretely presented component units is typically found in their enabling statutes and/or their bond resolutions where applicable. Those component units that are financing authorities generally may invest in government or government backed securities and deposits. The Michigan Education Trust's investments are subject to an investment agreement with the State Treasurer that allows the Treasurer, acting as agent, to make diverse investments including stocks, bonds, notes, and other investments. Investment policies for the State universities are typically set forth by their governing boards and include a broad range of investment types.

Restricted Assets

Restricted investments on the government-wide Statement of Net Assets, totaling \$346.8 million, represent amounts that are pledged toward the payment of outstanding bonds and notes.

Michigan
Notes to the Financial Statements

The following table summarizes the investment maturities reported by the discretely presented component units (in millions):

	Investment Maturities (In Years)					
	Fair Market Value	Less Than 1	1 To 5	6 To 10	More Than 10	N/A
Deposits:						
Time deposits	\$ 49.4	\$ 41.7	\$ 7.6	\$ -	\$ -	\$ -
Government money market accounts	71.0	71.0	-	-	-	-
Investments:						
Commercial paper	128.0	128.0	-	-	-	-
Short-term notes	98.8	95.2	1.5	1.9	.2	-
Repurchase agreements	326.5	15.6	300.8	-	10.2	-
Government securities	1,949.3	1,037.9	499.0	210.7	200.6	1.2
Insured mortgage backed securities	217.4	2.2	6.2	.3	208.7	-
Government backed securities	190.3	18.6	4.2	2.1	165.5	-
Investment agreements	31.0	10.3	-	-	20.7	-
Corporate bonds and notes	296.7	16.0	117.6	143.6	19.4	.1
Preferred stock	1.1	-	-	-	.9	.2
Equities	92.7	30.6	2.5	-	14.4	45.1
Real estate	3.6	.7	-	-	2.8	.1
Venture capital & leveraged buyouts	18.0	-	-	11.7	6.3	-
Government money market funds	11.5	6.8	4.7	-	-	-
Mutual Bond Funds	339.1	171.2	133.6	34.1	.2	-
Mutual Equity Funds	693.7	234.2	-	-	228.0	231.5
Guaranteed investment contracts	943.0	-	426.7	6.9	509.4	-
Pooled investment funds	22.1	22.1	-	-	-	-
Other investments	15.6	.8	-	-	13.6	1.2
Total Investments	<u>\$ 5,498.8</u>	<u>\$ 1,902.8</u>	<u>\$ 1,504.4</u>	<u>\$ 411.3</u>	<u>\$ 1,400.9</u>	<u>\$ 279.4</u>

Less Investments Reported as
"Cash" on Statement of Net Assets
Net Assets

477.5
\$ 5,021.3

As Reported on Statement of Net Assets

Current investments	\$ 1,318.4
Noncurrent restricted investments	346.8
Noncurrent investments	3,356.2
Total Investments	<u>\$ 5,021.3</u>

NOTE 9 – CAPITAL ASSETS

A. Primary Government

Summary of Significant Accounting Policies

Methods used to value capital assets

Capital assets, which include property, plant, equipment, and infrastructure items (e.g. roads, bridges, ramps, and similar items), are reported in the applicable governmental or business-type activity columns of the government-wide financial statements. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

Capitalization policies

All land and non-depreciable land improvements are capitalized, regardless of cost. Equipment is capitalized when the cost of individual items exceed \$5 thousand, and all other capital assets are capitalized when the cost of individual items or projects exceed \$100 thousand.

The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

Items not capitalized and depreciated

The State possesses certain capital assets that have not been capitalized and depreciated, because the assets are held for public exhibition, education, or research in furtherance of public service, rather than financial gain. These assets include works of art and historical treasures such as statues, monuments, historical documents, paintings, forts and lighthouses, rare library books, miscellaneous capitol-related artifacts and furnishings, and the like.

Depreciation and useful lives

Applicable capital assets are depreciated using the straight-line method, with a half-year's depreciation charged in the year of acquisition and in the year of disposal. Agencies assigned useful lives that were most suitable for the particular assets. Estimated useful lives generally were assigned as follows:

Asset	Years
Equipment	2-25
Buildings	5-50
Infrastructure	15-40
Land Improvements	5-40

Modified approach for infrastructure

The State has elected to use the "modified approach" to account for certain infrastructure assets, as provided in GASB Statement No. 34. Under this process, the State does not record depreciation expense nor are amounts capitalized in connection with improvements to these assets, unless the improvements expand the capacity or efficiency of an asset. Utilization of this approach requires the State to: 1) commit to maintaining and preserving affected assets at or above a condition level established by the State, 2) maintain an inventory of the assets and perform periodic condition assessments to ensure that the condition level is being maintained, and 3) make annual estimates of the amounts that must be expended to maintain and preserve assets at the predetermined condition levels.

Roads and bridges maintained by the Department of Transportation are accounted for using the modified approach.

Capital asset activities for the fiscal year ended September 30, 2005, were as follows (in millions):

	Beginning Balance (restated)*	Additions	Deletions	Adjustments and Reclass- ifications	Ending Balance
Governmental Activities					
Capital assets, not being depreciated:					
Land	\$ 3,113.7	\$ 66.4	\$ (2.0)	\$.4	\$ 3,178.5
Land improvements	17.2	-	-	-	17.2
Construction in progress	1,327.1	375.7	(561.4)	(122.3)	1,019.1
Infrastructure	11,747.3	507.3	(108.9)	-	12,145.7
Mineral rights	19.8	-	-	-	19.8
Total capital assets, not being depreciated	16,225.1	949.4	(672.3)	(121.9)	16,380.3
Capital assets, being depreciated:					
Land improvements	111.0	.8	(1.5)	-	110.3
Equipment and vehicles	695.2	127.3	(93.9)	(34.7)	693.8
Buildings	3,150.7	144.9	(60.4)	39.4	3,274.7

Michigan
Notes to the Financial Statements

Infrastructure	624.5	18.3	(2.5)	-	640.3
Total capital assets, being depreciated	4,581.4	291.3	(158.3)	4.7	4,719.2
Less accumulated depreciation for:					
Land improvements	(41.7)	(3.3)	1.1	-	(43.9)
Equipment and vehicles	(550.8)	(55.8)	38.2	5.8	(562.7)
Buildings	(1,108.9)	(94.4)	47.8	(1.1)	(1,156.7)
Infrastructure	(359.2)	(23.5)	2.4	-	(380.3)
Total accumulated depreciation	(2,060.5)	(177.1)	89.4	4.7	(2,143.6)
Total capital assets, being depreciated, net	2,520.9	114.2	(68.8)	9.4	2,575.6
Governmental activity capital assets, net	<u>\$ 18,746.0</u>	<u>\$ 1,063.6</u>	<u>\$ (741.1)</u>	<u>\$ (112.6)</u>	<u>\$ 18,955.9</u>

*Beginning balances for land, buildings, and equipment and vehicles in Governmental Activities were restated due to the transfer of the State Fair in the Department of Agriculture to a newly created component unit, Michigan Exposition and Fairgrounds Authority. Beginning balances for construction in progress and infrastructure were restated due to prior period errors. See Note 4 for additional information on these restatements.

Business-type Activities	Beginning Balance	Additions	Deletions	Adjustments and Reclass- ifications	Ending Balance
Capital assets, being depreciated:					
Buildings	\$ -	\$ -	\$ -	\$ -	\$ -
Equipment	4.8	.2	(.3)	-	4.7
Total capital assets, being depreciated	4.8	.2	(.3)	-	4.7
Less accumulated depreciation for:					
Buildings	-	-	-	-	-
Equipment	(4.3)	(.2)	.3	-	(4.2)
Total accumulated depreciation	(4.3)	(.2)	.3	-	(4.2)
Total capital assets, being depreciated, net	.6	-	-	-	.6
Business-type activity capital assets, net	<u>\$.6</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$.6</u>

Depreciation expense was charged to functions of the primary government as follows (in millions):

	Amount
Governmental Activities:	
General Government	\$ 22.4
Education	.3
Human Services	12.0
Public Safety and Corrections	50.1
Conservation, Environment, Recreation, and Agriculture	9.5
Labor, Commerce, and Regulatory	1.6
Health Services	6.2
Transportation	31.7
Depreciation on capital assets held by the State's internal service funds is charged to the various functions based on their use of the assets.	43.2
Total Depreciation Expense – Governmental Activities	<u>\$ 177.1</u>

Michigan
Notes to the Financial Statements

Business-type Activities:

Enterprise	<u>.2</u>
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Total Depreciation Expense – Business-type Activities	<u>\$.2</u>
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B. Discretely Presented Component Units

The following table summarizes net capital assets reported by the discretely presented component units (in millions):

	<u>Amount</u>
State Universities:	
Land and other non-depreciable assets	\$ 97.6
Buildings, equipment, and other depreciable assets	4,047.5
Infrastructure	132.6
Construction in progress	<u>87.9</u>
Total	4,365.5
Less accumulated depreciation	<u>(1,505.4)</u>
Capital Assets, net – State Universities	2,860.1
Capital Assets, net – Authorities	<u>143.3</u>
Capital Assets, Total – Discretely Presented Component Units	<u><u>\$ 3,003.4</u></u>